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Supreme Court of the United States

OCTOBER TERM, [redacted] 1950

No. 132

SPECTOR MOTOR SERVICE, INC., a Corporation,
Petitioner,

vs.

CHARLES J. McLAUGHLIN, Tax Commissioner,
DENNIS P. O'CONNOR, Substituted Defendant,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States:

I.

Summary Statement of Matter Involved.

This case, now that all the questions of local law have been eliminated, raises the question whether the Connecticut Corporation Business Tax Law, which is a tax upon the franchise of a corporation for the privilege of doing business in Connecticut, is in violation of the United States Constitution when it is sought to be applied to the plaintiff, a Missouri trucking corporation, engaged exclusively in interstate commerce.

The action to enjoin the assessment of tax by the defendant State Tax Commissioner and for a declaratory judgment holding that the plaintiff was not liable to pay such franchise tax, was begun in the United States District Court for the District of Connecticut where the court (Smith, *J.*) enjoined the defendant commissioner from collecting the tax on the ground that the act was not intended to apply to the plaintiff for if it were it would be unconstitutional (47 Fed. Supp. 671 (1942)). That decision was reversed by the United States Court of Appeals for the Second Circuit, one judge dissenting (139 Fed. 2d 809 (1943)), on the ground that the act was intended to apply to the plaintiff and was constitutional. On appeal to this court, the case was remanded to the District Court (323 U. S. 101 (1944)) until such time as questions of local law might be decided by the state courts of Connecticut. Accordingly the plaintiff brought an action for declaratory judgment in the Superior Court for Hartford County asking that the Corporation Business Tax Act be held not applicable to it and, if applicable, that it be declared unconstitutional. It also claimed the computation of the tax improper. The Superior Court (Comley, *J.*) held that the act was intended to apply to the plaintiff and was therefore in violation of the United States Constitution (15 Conn. Supp. 205 (1947)). On appeal, the Connecticut Supreme Court of Errors held that the act was applicable to the plaintiff and resolved all questions of local law against the plaintiff. It further held that it imposed "a tax or excise upon the franchise of corporations for the privilege of carrying on or doing business in the state whether they be domestic or foreign". The court, however, refused to pass on the federal constitutional questions, holding that in

view of the decision of this court "it is not for us to trench upon its right to decide those (constitutional) issues". (*Spector Motor Service, Inc.* v. *Walsh*, 135 Conn. 37, 41 (1948).)

Thereupon the defendant commissioner moved in the United States District Court of the District of Connecticut for the dissolution of the injunction which Judge Smith had issued in 1942. From Judge Smith's decision refusing to dissolve the injunction (88 Fed. Supp. 711 (1949)), the defendant appealed once more to the United States Court of Appeals for the Second Circuit. The case there was argued before Judges Swan, Clark and Frank. The District Court was again reversed on March 29, 1950, by the opinion of Judges Clark and Frank (who had also heard the earlier appeal). A dissent was filed by Judge Swan "for the reasons stated by the District Judge and by Judge Learned Hand in his dissent on the former appeal". The present petition for certiorari is to seek a review of that action of the Court of Appeals for the Second Circuit.

The facts, in brief, are that the Connecticut Act, the pertinent parts of which are included in the Appendix to this petition, provides that every corporation (with certain exceptions not here material) "carrying on business in this state" shall pay annually "a tax or excise upon its franchise for the privilege of carrying on or doing business within the state" of 2 per cent of the defined net income received "from business transacted within the state during the income year." (Section 418c Cum. Supp. to General Statutes.) By Section 176f effective July 1, 1937, after a portion of the taxes involved in this case had accrued, the tax was made applicable not only to those corporations carrying on business in Connecticut but also to those "having the right to carry on business in this state."

As to those corporations whose trade or business is carried on "partly without the state," Section 420c provides that the tax shall be imposed on a base "which reasonably represents the proportion of the trade or business carried on within the state." Interest, dividends, royalties and net gains from the sale of assets are allocated on the basis of their source. The same section provides that income derived from business other than the manufacture, sale or use of tangible personal or real property shall be allocated within and without the state under regulations of the tax commissioner. However, when income is derived from the manufacture, sale or use of tangible personal or real property, the portion to be attributed to "business within the state" is determined by an allocation fraction which is the simple arithmetical mean of the three following fractions:

(1) $\dfrac{\text{Average monthly fair cash value of taxpayer's tangible property in Connecticut}}{\text{Total average monthly fair cash value of all taxpayer's tangible property}}$

(2) $\dfrac{\text{Wages paid to employees from Connecticut offices}}{\text{Total wages paid all employees of taxpayer}}$

(3) $\dfrac{\text{Gross receipts from transactions chiefly negotiated and executed in Connecticut}}{\text{Taxpayer's total gross receipts (excluding income from interest and dividends or capital gains)}}$

The plaintiff claimed and the trial court found that it was engaged in carrying freight by motor exclusively in interstate commerce chiefly from Chicago and

St. Louis to the eastern seaboard and return and that it picked up and delivered freight in Connecticut but all in interstate commerce and that it had no power to engage in intrastate commerce and in fact at no time has so engaged. The plaintiff is a Missouri corporation with its executive offices in Chicago, Illinois. In Connecticut it maintains two rented depots for the transmission of freight in interstate commerce. It has 27 employees in Connecticut to service those depots but they are paid by draft on the plaintiff in Chicago, where all matters of rating and billing are handled. The plaintiff maintains a bank account in Bridgeport, Connecticut, where collections are deposited but no employee in Connecticut has authority to draw on that account. The plaintiff has no real estate in Connecticut and, apart from a few pick-up trucks, it owns in Connecticut personal property—mostly depot equipment—worth between $1500-$2000.

As the trial court found, the plaintiff, at the request of its landlord, on July 11, 1934, filed with the Secretary of the State of Connecticut a certificate of its incorporation in Missouri and also a certificate appointing the Secretary its attorney for service of process in Connecticut, pursuant to Section 3488, General Statutes of the State of Connecticut. That action, however, conferred no rights on the plaintiff because the plaintiff never was authorized, either by the Interstate Commerce Commission or by the Public Utilities Commission of Connecticut, to conduct an intrastate business. Its only purpose and effect was to subject the plaintiff to personal liability if it should default in its rent.

The defendant state tax commissioner, purporting to act under the Corporation Business Tax Act, assessed the plaintiff for taxes claimed to be due for

the years ending May 31, 1936, May 31, 1937, May 31, 1938, and for the period ending December 31, 1938, and for the years ending December 31, 1939, and December 31, 1940, aggregating the sum of $7,795.50.

The lengthy litigation through which this case has traveled has at least narrowed the issues. The Connecticut Supreme Court of Errors has defined the tax as an excise upon the privilege of doing business in Connecticut. The case now presents an issue which as Judge Learned Hand phrased it in his dissenting opinion is this: May a state levy "an excise directly upon the privilege of carrying on an activity which is neither derived from the state, nor within its power to forbid" (139 Fed. (2d) 809 at page 822).

II.

Statement of Jurisdiction.

That the District Court had jurisdiction of this case under the provisions of the Johnson Act 28 U. S. C. Sec. 1341 was decided by this court in its former opinion wherein it was stated, "The District Court had jurisdiction to entertain this bill and to give whatever relief is appropriate despite the Johnson Act and *Great Lakes Dredge Co. v. Huffman*, 319 U. S. 293, because of the uncertainty surrounding the adequacy of the Connecticut remedy" (323 U. S. 101 at page 105). Since that opinion, the Connecticut Supreme Court of Errors in its opinion in this very same case (135 Conn. 37, 61 Atl. (2d) 89) has cleared up the doubt as to the adequacy of the remedy in state courts and held that an action for declaratory judgment or for an injunction would lie in the state

courts. We submit that that opinion, however, does not oust the federal courts of jurisdiction. It was pointed out in *Dawson* v. *Kentucky Distilleries Co.*, 255 U. S. 288, that where no adequate state remedy was apparent when an action was instituted in the federal courts, federal jurisdiction was not defeated by a later opinion of the state supreme court indicating an available remedy. See also *American Life Insurance Co.* v. *Stewart*, 300 U. S. 203, 215.

Moreover, in this particular case, if the federal courts were to deny themselves jurisdiction, the plaintiff would be without a remedy in any court, because the Connecticut Supreme Court of Errors has specifically refused to decide the only issues left in the case, holding it is for the federal courts to do so. In this particular case, it would seem that even today there is no "plain, speedy and efficient remedy" in the state courts and for that reason alone the United States courts have jurisdiction.

The Court of Appeals acquired jurisdiction by virtue of the defendant's appeal pursuant to the provisions of 28 U. S. C. Sec. 1291. This court has jurisdiction to grant this petition for certiorari and to hear this appeal by virtue of the provisions of 28 U. S. C. Sec. 1254 (1) which authorizes this court, upon petition of a litigant to cause a case to be certified to it from the Court of Appeals for final determination.

The judgment of the Court of Appeals sought to be reviewed was entered on March 29, 1950, and this petition is being filed in the office of the clerk of this court within ninety days of the entry of said judgment as provided for in 28 U. S. C. Sec. 2101(c).

III.

The Questions Presented.

There are two questions which the plaintiff desires to present to this court if certiorari is granted.

1. The first is that the Connecticut Corporation Business Tax Act is unconstitutional because, in violation of the commerce clause of the United States Constitution (Article I, Section 8), it is an attempt by a state to impose an excise upon the right of the plaintiff to engage exclusively in interstate commerce.

2. The second is that the act is unconstitutional because it is in violation of the due process clause of the United States Constitution (Article XIV, Section 1, of the Amendments) as applied to the plaintiff.

In defining net taxable income the statute (419e Cum. Supp. General Statutes) did not allow "rent" to be deducted from gross income. The defendant has held that the cost of hiring trucks (which amounts to 60% of the plaintiff's operating expense) is "rent" and therefore not deductible. As a result, the assessment is not a tax on net income but approaches a tax on gross income in interstate commerce and is therefore unfair, discriminating and in violation of due process.

IV.

Reasons Relied on for the Allowance of the Writ.

When we filed in this court our first petition for certiorari, we did not file an accompanying brief (nor do we now) but relied on the majority and minority opinions in the then Circuit Court of Appeals to demonstrate that this case presented a problem of a type and importance to merit a review by this court. Every reason which induced this court to grant certiorari then is present now. In addition, we have complied with the mandate of this court and have cleared away all local issues leaving only the constitutional problems which can be finally resolved by this court and no other.

This court will recall that the first opinion of the majority of the Court of Appeals recognized that on the basis of decided cases the statute here in question was unconstitutional as the District Court had held. The majority, however, noting what they considered "foreshadowing trends" felt impelled to anticipate the overruling of those decided cases. When this matter, after having been through the state courts, came once more before the District Court, that court, following the decided cases, held again the act to be unconstitutional. On the second appeal to the Court of Appeals, the same two judges again constituting a majority of the court, reversed the trial court stating their position as follows:

> "When we had this case before us six years ago we expressed the view that earlier decisions, of which *Alpha Portland Cement Co.* v. *Common-*

wealth of Massachusetts, 268 U. S. 203, was the principal authority, were against the validity of a state tax levied upon even net income of a corporation engaged solely in interstate commerce. But on examination of the broad trends in favor of the state-taxing power shown by the Supreme Court, we concluded that the *Alpha Portland Cement* case and its progeny were no longer controlling and that as of that date the validity of such a tax as this would be sustained. We are now called upon to re-examine our conclusions to see if, as indeed the learned trial judge thought, later developments show that we were in error.

"Before embarking upon this task, we think it needful that we redefine what we conceive to be our functions as judges of a constitutionally inferior court; for it seems to have been thought in some quarters that our previous attempt to study doctrinal trends as to the fate of state taxation in interstate commerce was only an endeavor to guess the votes of Supreme Court justices. We certainly have no desire either to psychoanalyze or to Gallup-poll the Court and its newer members, nor do we conceive that to be greatly useful to it or to others. We recognize, too, that it would be futile and undignified not to yield obeisance to ancient precedents solely because we personally think they have outlived their usefulness; but it would be equally futile to press them upon the parties when they are no longer more than wraiths."

The problem of six years ago remains unsolved. The majority opinion is still frankly and admittedly in conflict with the applicable decisions of this court.

In addition to the *Alpha Cement* case already cited reference is had to the following:

Ozark Pipe Line Corp. v. *Monier*, 266 U. S. 555;
New York ex rel. v. *Knight*, 192 U. S. 21;
Cooney v. *Mountain States Telephone Co.*, 294 U. S. 384;
Puget Sound Stevedoring Co. v. *Tax Commission*, 302 U. S. 90;
Anglo-Chilean Nitrate Corp. v. *Alabama*, 288 U. S. 218.

Between the time of the first and second decisions of the Court of Appeals the cases of *Joseph* v. *Carter and Weekes Stevedoring Co.*, 330 U. S. 422, and *Interstate Oil Pipe Line Co.* v. *Stone*, 337 U. S. 662, were decided by this court. These cases seem to us to indicate that this court is acutely conscious of the peril to interstate commerce if the right to engage in it is subject to state taxation. As Judge Hand has pointed out the states have "representation in Congress which the nation has not in their legislatures". It is important therefore that interstate commerce be given by this court its full constitutional protection. So long as the two opinions of the Court of Appeals are the law of this case "a long course of constitutional history and an 'unbroken line of decisions' would indeed be brought into question" *Spector Motor Co.* v. *McLaughlin*, 323 U. S. 101 at page 103.

So far as the question of due process is concerned since this case was last before this court it is significant that the Connecticut legislature has amended the statute so that "rent" is a now deductible item. It is a recognition of our position that the statute was unconstitutional. By labeling as "rent" the cost of hiring trucks (which constitutes 60% of Spector's total oper-

ating costs) and then by refusing to allow such "rent" to be deducted from gross income in determining net income, Connecticut subjected the plaintiff substantially to a tax on gross income outlawed by *Gwin* v. *Henneford,* 305 U. S. 434, and cases cited. In fact the impropriety of the assessment was so clear that the defendant without legislative sanction adopted a rule of thumb whereby 60% of the cost of hiring trucks was allowed as an operating expense and thus made deductible. That compromise however only mitigates but does not remove the intrinsic injustice of the defendant's refusal to recognize as an operating expense the cost of hiring trucks from other operators.

WHEREFORE your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Honorable Court directed to the United States Court of Appeals for the Second Circuit commanding that court to certify and to send to this court for its review and determination on a day certain to be therein named, a transcript of the record and proceedings herein; and that the decree of said Court of Appeals be reversed by this Honorable Court and your petitioner have such other and further relief in the premises as to this Honorable Court may seem meet and just.

PETITIONER,

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APPENDIX.

Section 418c, 1935 Supplement to the General Statutes:

Sec. 418c. Imposition of tax. Every mutual savings bank, savings and loan association and building and loan association doing business in this state, and every other corporation or association carrying on business in this state which is required to report to the collector of internal revenue for the district in which such corporation or association has its principal place of business for the purpose of assessment, collection and payment of an income tax, except (1) insurance companies, (2) companies principally engaged in the transportation and communication business and subject to the gross earnings taxes under chapters 70, 71 and 72, (3) companies principally engaged in manufacturing, selling or distributing gas, electricity or water and subject to the gross earnings tax imposed under chapter 73 and (4) companies all of whose properties in this state are operated by companies subject to taxation under chapters 70, 71, 72 and 73, shall pay, annually, a tax or excise upon its franchise for the privilege of carrying on or doing business within the state, such tax to be measured by the entire net income as herein defined received by such corporation or association from business transacted within the state during the income year and to be assessed at the rate of two per cent; provided in no case shall the tax be less than the minimum tax as computed under section 421c and provided, when any company taxable under chapter 71 shall engage in any business in this state other than the carrying of passengers for hire in common carrier motor vehicles, such company shall

be subject to a tax of two per cent measured by that portion of its total net income derived from such business but shall not be subject to the minimum tax computed under section 421c. Notwithstanding any other provisions of this chapter, any mutual savings bank owning at the end of the income year, real estate acquired for debt having an assessed valuation of ten per cent or more of its total assets shall, during the calendar years 1936 and 1937, be subject to the lesser of (1) the tax imposed by this chapter and (2) the tax imposed by chapter 68 as amended by section 355b of the 1933 supplement.

Section 419c, 1935 Supplement to the General Statutes:

Sec. 419c. Deductions from gross income. In arriving at net income as defined in section 417c whether or not the taxpayer is taxable under the federal corporation net income tax, there shall be deducted from gross income all items deductible under the federal corporation net income tax law effective and in force on the last day of the income year, except (1) federal taxes on income or profits, losses of prior years, interest received from federal, state and local government securities and specific exemptions, if any such deductions shall be allowed by the federal government and (2) interest and rent paid during the income year.

Section 420c, 1935 Supplement to the General Statutes:

Sec. 420c. Allocation of net income. If the trade or business of the taxpayer shall be carried on partly without the state, the business tax shall be imposed on a base which reasonably represents the proportion of the trade or business carried on within the state. The

allocation of the base of the tax measured by net income shall be made on the following basis: (1) Interest, dividends, royalties and gains from sales of intangible assets, less related expenses, when received by a company having its principal place of business within the state, shall be allocated to the state and, when received by a company having its principal place of business without the state, shall be allocated without the state; provided, when it can be clearly established that such income is received in connection with business within the state, such income shall be allocated to the state without regard to the location of the principal place of business of the taxpayer, and a similar rule shall apply to such income received in connection with business without the state; (2) gains from sales or rentals of tangible capital assets held, owned or used in connection with the trade or business of the taxpayer but not for sale or for rent in the regular course of business shall be allocated to the state if the property sold or rented be situated in the state prior to the sale or during the rental thereof, otherwise such gains shall be allocated outside the state; (3) net income of the above classes having been separately allocated and deducted as above provided, the remainder of the net income of the taxpayer shall be allocated and apportioned as follows: (a) Such income, when derived from business other than the manufacture, sale or use of tangible personal or real property, shall be specifically allocated within and without the state under rules and regulations of the tax commissioner; (b) when derived from the manufacture, sale or use of tangible personal or real property, the portion thereof attributable to business within the state shall be determined by means of an allocation fraction to be computed as the simple arithmetical mean of three

fractions. The first of these fractions shall represent that part of the average monthly fair cash value of the total tangible property held and owned by the taxpayer during the income year which is held within the state, without deduction on account of any incumbrance thereon but excluding any property the income of which is separately allocated under the foregoing provisions of this chapter. The second fraction shall represent the part of the total wages, salaries and other compensation to employees paid by the taxpayer during the income year from offices, agencies or places of business within the state, provided all such payments shall be assigned to the office, agency or place of business of the taxpayer at which the employee chiefly works or from which he is sent out or with which he is chiefly connected. The third fraction shall represent the part of the taxpayer's gross receipts from sales or other sources during the income year, excluding any income which is specifically allocated under subdivisions (1) and (2) of this section, which is assignable to offices, agencies or places of business within the state, provided such receipts shall be assigned to that office, agency or place of business at or from which the transactions giving rise thereto are chiefly negotiated and executed.